F I S C A L   I M P A C T   R E P O R T

		ORIGINAL DATE	01/27/12		
SPONSOR	Trujillo	**LAST UPDATED**		**HJR**	1
SHORT TITLE	Preserve Land Grant Permanent Fund, CA			**SB**	
				ANALYST	Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue			**Recurring or Nonrecurring**	**Fund Affected**
FY12	**FY13**	**FY14**		
		Indeterminate	Recurring	Land Grant Permanent Fund
	Minimal		Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SJR 4

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
Attorney General's Office (AGO)

SUMMARY

Synopsis of Bill

House Joint Resolution 1 proposes to remove an existing constitutional limitation of 15% of the Land Grant Permanent Fund (LGPF) allowed to be invested into international equity/stock markets.

The resolution is endorsed by the Investments and Pensions Oversight Committee, which also endorsed a companion bill to the resolution (SB 41), which would establish a new cap on international investments of 25%, but place that restriction under the purview and oversight of the legislature by statute. Neither the resolution nor the bill require additional international investments be made, but only allow the option for the State Investment Council to do so, should it deem such a strategy appropriate in its efforts to prudently grow the LGPF.

SJR 4 also proposes to increase the constitutional 'standard of care' required to manage the LGPF from that of 'ordinary prudence' to that of 'prudent investor'. In addition to improving the standard to which this fund must be managed, this adjustment would also resolve an existing conflict between the constitution and state statute relative to this language, as it applies to governance of the SIC and LGPF.

FISCAL IMPLICATIONS

A previous analysis of a similar bill requiring a constitutional amendment cites estimates by the Secretary of State's Office as to costs related to putting a constitutional amendment on all state ballots. Printing costs in 2011 were estimated by SOS at $104k.

SIC: Though future impact to the LGPF is indeterminate, failure to remove the cap could result in limited or artificially depressed investment returns for the LGPF over time, especially during times of economic growth and market expansion. Today and during the recent decade, many institutional investors have targeted international allocations upward of 20%, for which they have been largely rewarded. The following annualized return numbers are based on 12/31/11 reporting, and compare benchmark indexes for the S&P 500, MSCI International Developed and MSCI International Emerging stock indexes.

	1-Year	3-Years	5-Years	7-Years	10Yrs
S&P 500 Index	2.11	14.11	-0.25	2.64	2.92
MSCI EAFE Index (Intl Dev)	-12.14	7.65	-4.72	1.71	4.67
MSCI Emg Mkts Index	-18.42	20.07	2.40	10.36	13.86

While domestic markets saw short term out-performance last year, over the past 10-years, greater exposure to emerging markets in particular helped improve returns for many investors.

SIGNIFICANT ISSUES

Per SIC:

- Today, about 55% of the global publicly-traded equities market capitalization (global stock market value) is represented by shares of companies domiciled outside of the US.
- Foreign market investment opportunities exist in fixed income, real estate and private equity (each of these an asset class the SIC currently invests in) in increasing amounts with competitive, and often better, expected returns than in the US.
- Contribution to global GDP growth is increasingly shifting to the emerging markets. GDP growth drives investment opportunity and return.
- Diversification of assets is a critical component of risk control in portfolio construction and the LGPF portfolio could be better diversified with increased access to the international investment markets.
- SIC portfolios are routinely compared in terms of performance and professional management to portfolios of peers, who have greater access to the increased-return and risk-reducing benefits of unlimited international investments.
- It should be noted that ERB & PERA are among the vast majority of institutional investors that do not have this particular constitutional (or statutory) restraint.

The State Investment Council, like institutional investors in more than 40 other states, is governed under the Uniform Prudent Investor Act (UPIA). The Council recognizes that as fiduciaries, one of the most important roles members have is to ensure proper diversification of the portfolio. In doing so, they seek to strike a strategic investment balance of non-correlated assets, each with an appropriate risk-adjusted return profile, and which in aggregate combine to create a complementary basket of investments that optimize the long-term rate of return to the Fund.

In addition, many economists believe that in the wake of the financial crisis three years ago, which continues to strongly impact more mature economies like Europe, the domestic recovery will be a cautious one, hastening a potentially extended period of slow growth in the US. It is now more important than ever to be able to properly access investment markets which will continue to see accelerated economic growth and high rates of GDP. Generally, many investors are looking to international emerging markets for these characteristics, with the understanding that while these assets do carry a higher level of volatility, that there is a premium being paid to those who take that risk. The Council believes that as fiduciaries to the Fund, it should have the ability to assess and accept this risk if appropriate, rather than be handcuffed by an artificial and dated limitation. Our consultants strongly agree.

PERFORMANCE IMPLICATIONS

The potential investment performance impact is indeterminate and will depend on future market trends. Historically however, it should be noted that over the last decade domestic equities have underperformed emerging international markets to a high degree, and to a lesser extent, developed international markets.

ADMINISTRATIVE IMPLICATIONS

Should HJR 1 pass and be approved by voters, the SIC will revisit investment allocation targets and possibly portfolio re-balancing.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Per SIC:

While the intent of the 15% constitutional limitation is not fully understood today, it is believed that at the time it was put in place many years ago, international investments were viewed as highly volatile and risky. Today, with ongoing maturation of emerging economies and the strong growth in developing countries, there is a greater recognition of a "global economy". Recognizing this, the 15% cap is simply an antiquated mechanism that has outlived its usefulness.

Regarding the existing statutory/constitutional conflict relative to ordinary prudence versus UPIA standard management of the LGPF, it should be noted that in 2010, Ennis Knupp in their independent fiduciary review, specifically identified this problem and recommended it be remedied soon. This conflict is especially problematic as there is a strong possibility that from a legal standpoint, the Constitution will typically override statutory mandate.

HJR 1 relates to SB 41 & HB 21, which would establish a cap on LGPF international equity investments at 25% by statute, rather than constitution. It also relates to SJR 4, which is a duplicate bill. (NOTE: Duplicates for HB21 & HJR1 were dropped in the Senate and will be pursued there due to concerns the SIC had regarding a perceived conflict between other LGPF-related legislation pre-filed by Rep. Trujillo. Both the Representative, Senator Cisneros and the LCS are aware of this duplicate bill issue, and requested the exception be made to standard legislative practice restricting duplicate bills).

OTHER SUBSTANTIVE ISSUES

One can make the argument that having a constitutional restriction placing a percentage cap on a particular type of investment may, in extreme market environments, bring the Council into direct conflict with the Uniform Prudent Investor Act, under which the SIC operates by statute.

ALTERNATIVES

The cap could be left in the state Constitution at an elevated level (say 25%). The drawback to this scenario would be that while it would give the Council additional fiduciary flexibility, it may at some future date again become a hindrance on optimizing market returns.

Another alternative would remove the cap, but not reestablish it through statute, allowing the Council to set allocation investment boundaries through policy.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

New Mexico will continue to be hindered by a dated and artificially imposed investment restriction that challenges proper investment allocation and strategy, as the Council works to prudently manage the second largest sovereign wealth fund in the United States.

EWM/lj:svb